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C O N F I D E N T I A L SECTION 01 OF 02 SHENYANG 000008

NOFORN
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DEPARTMENT FOR EAP/K, EAP/CM, INR

E.O. 12958: DECL: TEN YEARS AFTER KOREAN REUNIFICATION

TAGS: [CH](#) [ECON](#) [EFIN](#) [EIND](#) [EMIN](#) [KN](#) [KS](#) [PGOV](#) [PREL](#) [SENV](#)

SUBJECT: TRYING TO TAME THE INFLATIONARY BEAST

Classified By: Consul General Stephen B. Wickman. For Reasons 1.4 (b) a
nd (d)

¶1. (C) Summary: On January 3, a Consulate contact who delivers oil to North Korean partners told PolOff in strict confidence that millions of dollars currently sit unclaimed in China Merchant Bank accounts opened by North Korean businessmen and government officials recalled from China in the spring of 2009, caught in the DPRK's currency reform, which was likely a vain attempt to stem inflation. Without improved ties to the U.S., the DPRK will show no improvements, despite ambitious plans. He compared the DPRK business environment to that of the former Soviet Union. While "face" is important in negotiating honestly, system cleavages ensure that deals are broken for personal gain. End Summary.

A POLICY DESTINED FOR FAILURE?

¶2. (C) According a Dandong-based oil trader, who requested strict protection in a meeting with Poloff on January 3, millions of dollars currently sit in the China Merchants Bank in accounts held by North Korean businessmen and government officials recalled from China during the initial promotion of Kim Jong-un as successor in the spring of 2009, while Kim Jong-il recovered from his stroke. The accounts, opened using legitimate North Korean passports (i.e. issued to the account holder), borrowed North Korean passports, or Chinese I.D. cards, can only be accessed with a code known to the account holder. The contact opined that the money will likely remain untouched for the foreseeable future due to new currency policies making it difficult to use and hold foreign currency in North Korea.

¶3. (C) Also according to our contact, the currency exchange and revaluation came as the DPRK government took steps to combat high inflation and has had a negative impact on business. He compared the situation to rampant inflation in Ecuador in the early 2000s and pointed out that on his most recent trip to the DPRK (which pre-dated currency reform - one kilogram (kg) of sea cucumbers cost more than USD 110 per kg). He called this a massive price increase compared to a previous trip three or four months prior and representative of economy-wide inflation. Due to the currency revaluation, our contact did no business in North Korea in the month of November, despite having contracts in place for continued oil delivery. This caused the contact's DPRK partner to lose several hundred thousand dollars. The contact did not specify the amount of his own losses. While business has since resumed, most trade between China and the DPRK remains at a near standstill. He added that civil servants and the middle class (e.g. teachers) were particularly hard hit as they cannot exchange money earned outside of their jobs without

explaining the origin of the money.

¶ 14. (C) The contact believes the new currency policy will not have the intended effect of controlling inflation. The closing of markets that used foreign currency has compounded the scarcity problem. Nearly all trade must now be done in North Korean won, though our contact's oil trades continue to be dollar-denominated. Finally, the North Korean people continue to lack faith in the new currency, which is causing continuing economic uncertainty and creating high demand for ever scarcer goods, according to our contact.

A LITTLE HELP HERE?

¶ 15. (C) Our contact also shared his opinions on broader DPRK policy. He believes North Korea wants first and foremost improved ties with the United States, though the nuclear issue makes this unlikely. He has also heard talk in North Korea of new measures to improve agricultural production and light industry, and to increase foreign trade. However, because of the DPRK's increased restrictions on coal and timber exports, limits on mining exports, lack of an industrial base, and limited ability to increase agricultural outputs, he sees progress as highly unlikely. He pointed to the contradiction between North Korea's attempts to seek improved ties with the outside world while simultaneously demanding greater domestic economic control. He also reported that overfishing has lead to decreased seafood production and exports. Without improved ties to the U.S., he concluded, North Korea will not recover.

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¶ 16. (C) Our contact compared doing business with North Korea to doing business with the former Soviet Union. North Koreans (like the Chinese) place a high importance on issues of "face" and contract negotiations are pursued in good faith. As in the Soviet Union, however, the system does not support good-faith contracts, resulting in North Korean supervisors breaking contracts for their own gain. He experienced significant cash losses due to broken contracts when he first began dealing with the DPRK in the 1992-97 period. As a result, he ceased dealing with many former clients and now only does business with a few powerful, credit- and trustworthy official counterparts in the oil and logistics business. He generally sources oil destined for western North Korea from Russia, while sourcing oil sent to the east coast from southern China. The ships he uses to deliver oil carry 2,000-3,000 tons. He has provided 12 trucks that currently run throughout the DPRK carrying goods. The trucks and shipments are managed by a state-owned, North Korean joint-venture partner.

¶ 17. (C) During our meeting, the contact stopped several times to reiterate his desire for our conversation to remain private. He does not want his name known. He works for a powerful Chinese State-owned enterprise, and the oil companies with which he does business in North Korea are powerful organizations in their own right. He also said DPRK secret police are extremely effective and powerful, even in running operations across the border in China. He often looked around the room nervously during our meeting, rubbing his neck, face and hands. He said Australian and Canadian reporters had somehow come across his name and phone number and had pestered him for information. He said he found this extremely discomfiting.

WICKMAN